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Attorneys for ROBERT J. NAGY

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA
SAN FRANCISCO DIVISION

UNITED STATES OF AMERICA,

Plaintiff,

vs.

CHARLES CATHCART, et al.,

Defendants.

Case No. C-07-4762-PJH

**DECLARATION OF TOM
PROUNTZOS IN SUPPORT OF
DEFENDANT ROBERT J. NAGY'S
MOTION TO STAY THE
PROCEEDINGS OR IN THE
ALTERNATIVE TO SEVER ALL
CLAIMS AND TRANSFER VENUE
PURSUANT TO 28 U.S.C. 1404(a)**

Date: September 10, 2008

Time: 9:00 a.m.

Dept.: Room 3, 17th Floor

Trial: March 23, 3009

I, TOM PROUNTZOS, am an attorney duly licensed in the courts of the State of California and am an attorney at Jenkins Goodman Neuman & Hamilton LLP, attorneys of record for Defendant ROBERT J. NAGY.

1. Attached hereto as Exhibit 1 is a true and correct copy of the Declaration of

-1-

DECLARATION OF FARLEY J. NEUMAN IN SUPPORT OF DEFENDANT ROBERT J. NAGY'S
MOTION TO STAY THE PROCEEDINGS OR IN THE ALTERNATIVE TO SEVER ALL
CLAIMS AND TRANSFER VENUE PURSUANT TO 28 U.S.C. 1404(a)

1 Robert J. Nagy.

2 2. Attached hereto as Exhibit 2 is a true and correct copy of the Complaint of
3 Robert J. Nagy filed in the District of South Carolina, Charleston Division (No. 2:08-cv-
4 02555-MNS) on July 15, 2008.

5
6 DATED: July 30, 2008

JENKINS GOODMAN NEUMAN
& HAMILTON LLP

7
8
9 By: 

TOM PROUNTZOS
Attorneys for ROBERT J. NAGY

EXHIBIT 1

1 FARLEY J. NEUMAN, ESQUIRE - State Bar #100021
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5 Attorneys for ROBERT J. NAGY

6
7
8 UNITED STATES DISTRICT COURT
NOTHERN DISTRICT OF CALIFORNIA
9 SAN FRANCISCO DIVISION

10
11 UNITED STATES OF AMERICA,
12 Plaintiff,

13 vs.

14 CHARLES CHATHCART, SCOTT
CATHCART, YURIJ DEBEVC, a/k/a
15 YURI DEBEVC, ROBERT NAGY,
DERIVUM CAPITAL, LLC,
16 DERIVUM CAPITAL (USA), INC.,
AND VERIDIA SOLUTIONS, LLC,

17 Defendants.
18

Case No. C-07-4762-PJH

**DECLARATION OF ROBERT J. NAGY
IN SUPPORT OF MOTION TO SEVER
ALL CLAIMS AND TRANSFER
VENUE PURSUANT TO 28 U.S.C.
1404(a)**

Date: June 25, 2008
Time: 9:00 a.m.
Dept.: Room 3, 17th Floor

Trial Date: March 23, 2009

19 I, Robert J. Nagy, under 28 U.S.C. § 1746, declare as follows:

20 1. I am a named defendant in the above-captioned lawsuit pending in the
21 United States District Court for the Northern District of California.

22 2. This Declaration is submitted in conjunction with a Motion to Sever All
23 Claims and Transfer Venue Pursuant to 28 U.S.C. 1404(a), which seeks to transfer all
24 claims against me in the present suit from the United States District Court for the Northern
25 District of California to the United States District Court for the District of South Carolina.
26

Jenkins Goodman
Neuman & Hamilton
LLP
417 Montgomery St.
10th Floor
San Francisco, CA
94104
(415) 705-0400

1 3. I currently reside in Charleston County, South Carolina. I am a licensed
2 certified public account in the State of South Carolina and maintain an accounting practice
3 located at 180 East Bay Street, Suite 201, Charleston, South Carolina. I was licensed in
4 1977, and have been a practicing accountant in South Carolina from 1974 to the present.

5 4. The current action for injunction against me by the United States is based in
6 part on alleged violations of Section 6700 of the Internal Revenue Code¹ ("Section 6700").
7 This action was commenced on September 17, 2007.

8 5. After the IRS initiated this injunction action and after I answered the
9 Complaint, the IRS then assessed me on December 27 and 28, 2007 with approximately
10 \$8.2 million in penalties under Section 6700 for the 1997 to the 2005 tax years. A notice
11 of federal tax lien was also filed against me based on these Section 6700 penalties. A true
12 and correct copy of the notice of assessments and notice of federal tax lien is attached as
13 Exhibit 1.

14 6. Within 30 days of being given notice of the assessments, and pursuant to
15 section 6703(c) of the Internal Revenue Code, I timely filed claims for refund with the IRS
16 on January 23, 2008 requesting that the IRS abate the \$8.2 million in Section 6700
17 penalties for the 1997 to the 2005 tax years. The basis for my claims for refund is that I
18 did not violate Section 6700.

19 7. If the claims for refund are allowed, the Section 6700 penalties will be
20 abated, and I will not be liable to the IRS. If the claims for refund are denied, I will
21 promptly file refund litigation against the United States in the United States District Court
22 for South Carolina under section 6703(c)(2) of the Internal Revenue Code and section
23 7422 of the Internal Revenue Code. Alternatively, if the IRS does not act on my claims for
24 refund within six months of the date I filed them, I will also file refund litigation against
25 the United States in the United States District Court for South Carolina pursuant to section

26 ¹ Title 26 of the United States Code.

1 6703(c)(2) of the Internal Revenue Code ("South Carolina Refund Litigation").

2 8. I have retained Lindsey W. Cooper, Jr., an attorney in South Carolina, to
 3 represent me with respect to the Section 6700 penalties and to file the South Carolina
 4 Refund Litigation if my claims for refund are denied. It is my understanding that the
 5 issues in the South Carolina Refund Litigation would be the same as those in the present
 6 injunction action, as the activity or activities in which the IRS alleges I engaged are the
 7 basis for both the injunction action and the penalty assessments. Nonetheless, because the
 8 United States has pursued the injunction action in California, I am now compelled to deal
 9 with these issues in two separate states, with two separate attorneys, resulting in
 10 considerable additional time and expense.

11 9. I am informed and believe that if I pursue the South Carolina Refund
 12 Litigation, I will be entitled to a trial by jury under the Seventh Amendment to the
 13 Constitution. I intend to avail myself of this right to a jury trial.

14 10. I am also informed and believe that such refund litigation will involve a
 15 determination of whether I violated Section 6700 of the Internal Revenue Code, which is
 16 also an issue in the present injunction action.

17 11. I am further informed and believe that if the issue of whether I violated
 18 Section 6700 is adjudicated in the present injunction action first, that I will be precluded or
 19 estopped or otherwise prevented from litigating this issue in the refund action.

20 12. I am further informed and believe that I have no right to a jury trial in the
 21 present action for injunction.

22 13. I am further informed and believe that if the issue of whether I violated
 23 Section 6700 is adjudicated in the present injunction action and I am estopped from
 24 litigating it in the South Carolina Refund Litigation, that I will be denied my right to a jury
 25 trial with regard to that issue in violation of the Constitution.

26 14. Based on this potential deprivation of my constitutional right to a jury trial, I

1 intend to file a motion to stay the present injunction action immediately after I file the
2 South Carolina Refund Litigation.

3 15. I am informed and believe that this Court will be bound to grant a motion to
4 stay the proceedings pursuant to the precedent of *United States v. Nordbrock* (1991 9th
5 Cir.) 941 F.2d 947.

6 16. I have taken steps to try to expedite the apparent inevitable need to file the
7 South Carolina Refund Litigation, including requesting that the IRS deny my refund
8 claims immediately so that I may immediately file a refund action. I have also sent a
9 waiver of notice of disallowance to the IRS so my claims for refund could immediately be
10 denied. A copy of the Waiver of Statutory Notification of Claim Disallowance and cover
11 letter are attached as Exhibit 2. Mr. Cooper has also attempted to prompt the IRS to act.
12 None of our efforts, however, have resulted in action on my refund claims. I have been
13 informed by Mr. Cooper that he was told by Marie Allen, a Revenue Agent with the IRS,
14 that the IRS would not act on my refund claim "for a long time".

15 17. I have never been a member, manager or had any direct or indirect
16 ownership in Derivium Capital, LLC ("Derivium"). I have never been an employee of
17 Derivium.

18 18. Derivium was a client of my accounting firm for which I prepared tax returns
19 and provided tax advice regarding the 90% loan transactions. The advice I provide
20 concerning the 90% loan transactions was to my client Derivium.

21 19. In providing advice to Derivium, I mainly communicated with Charles
22 Cathcart who was a manager of Derivium and lived in Charleston, South Carolina. The
23 individuals with whom I communicated at Derivium were located in South Carolina as
24 Derivium is a South Carolina limited liability company.

25 20. Derivium's ongoing bankruptcy proceeding is in South Carolina, and its
26 corporate documents are in the possession of the trustee in Charleston, South Carolina.

21. I traveled to California one time in my capacity as Derivium's outside accountant or tax advisor. I never met or communicated with any Derivium borrowers while in California. I can only recall traveling to California two other times over the course of my life prior to the filing of this lawsuit. One trip was for business wholly unrelated to Derivium, and one trip was entirely personal.

22. In my answer to the United States' complaint, I denied that venue was appropriate in California for the reasons stated above. (Nagy Answer ¶¶1-2.)

23. The IRS assessed the Section 6700 penalties against me after filing the present injunction action, and I will be required to file my refund claim in South Carolina to dispute the assessments. It is a substantial burden and hardship to me to have to litigate the same Section 6700 issue in two separate proceedings and in two separate jurisdictions on opposite coasts. The IRS unilaterally caused this burden and procedural issue by waiting to assess the Section 6700 penalties until after it initiated the filing of the present lawsuit and by refusing to expeditiously act on my claims for refund.

24. By refusing to act quickly on my claim for refund, the IRS is causing me unnecessary time and expense, as well as interfering with the judicial economy of the Court's time.

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

Executed on April 24, 2008.



Robert J. Nagy
180 East Bay Street, Suite 201
Charleston, SC 29401

EXHIBIT 2

IN THE UNITED STATES DISTRICT COURT FOR THE
DISTRICT OF SOUTH CAROLINA
CHARLESTON DIVISION

ROBERT J. NAGY,)	
)	No.
Plaintiff,)	
)	
v.)	JURY TRIAL DEMANDED
)	
UNITED STATES OF AMERICA,)	
)	
Defendant.)	

COMPLAINT

Robert J. Nagy, through undersigned counsel, brings this complaint against defendant, the United States of America, and alleges as follows:

JURISDICTION AND VENUE

1. Jurisdiction is conferred upon this Court by 28 U.S.C. §§ 1331, 1340 & 1346, as well as 26 U.S.C. §§6703, 7431 & 7433.

2. Venue is proper in this district under 28 U.S.C. §§1391 & 1396.

PARTIES

3. Plaintiff, Robert J. Nagy, is a natural person who resides within Charleston County, South Carolina.

4. Defendant, the United States of America, is the sovereign.

CLAIM I
(Erroneous & Illegal Assessment of Section 6700 Penalties)

5. Nagy incorporates paragraphs 1 to 4 above as if realleged verbatim herein.

6. On or about March 16, 2006, the Internal Revenue Service ("IRS") began to send letters to Nagy notifying him that the IRS was considering penalties against him for his alleged participation in a tax avoidance transaction. In accordance with the Internal Revenue Manual ("I.R.M."), the letter indicated that Nagy would be afforded the opportunity to present any facts or legal arguments before any assessment would be made.

7. Under 26 U.S.C. §6700(a), the IRS maintains the burden of proof in any proceeding to establish that any person is liable under Section 6700.

8. On December 31, 2007, the IRS made the following assessments against Nagy under 26 U.S.C. §6700:

Tax Period	Assessment Date	Assessment Amount
1997	12.28.2007	\$16,000
1998	12.28.2007	\$119,000
1999	12.28.2007	\$388,000

Tax Period	Assessment Date	Assessment Amount
2000	12.28.2007	\$749,000
2001	12.28.2007	\$519,000
2002	12.28.2007	\$270,000
2003	12.28.2007	\$231,000
2004	12.28.2007	\$2,929,620
2005	12.28.2007	\$2,873,188
	Total Amount	\$8,094,808

9. The IRS, acting on behalf of the United States, erroneously and improperly assessed Nagy for civil promoter penalties under 26 U.S.C. §6700.

10. Prior to making the assessments under 26 U.S.C. §6700, Nagy was never afforded the opportunity to present any facts or legal arguments before any assessment was made, in contradiction to the IRS's affirmative representation in its notification letters and in contradiction to the I.R.M.'s requirements.

11. The pre-assessment deficiency procedures that apply to assessment and collection of other taxes and penalties do not apply to Section 6700 assessments under 26 U.S.C. §6703(b). Thus, the IRS is

excused from giving notice to a taxpayer before making a Section 6700 assessment. As a result, the taxpayer is not afforded the procedures to challenge the IRS's determinations before the IRS makes its assessments and begins collection.

12. Nagy made written requests on four separate occasions asking the IRS to provide information in support of its assertion that Nagy was promoting a tax shelter transaction. The IRS never responded or provided Nagy with a basis for the Section 6700 assessments against him prior to December 28, 2007.

13. On January 23, 2008, Nagy paid 15% of the penalties assessed against him for the 1997 to 2005 tax years and filed claims for refund as required by 26 U.S.C. §6703(c)(1). (Ex. 1.)

14. For Section 6700 penalty assessments made after October 22, 2004, the penalty was amended from being \$1,000 per activity to 50% of the income to be or expected to be derived from the activity on which the penalty assessment is predicated.

15. Because the IRS did not timely provide Nagy with the underlying assessment information for the 2005 tax year, Nagy was prohibited from paying 15% of a penalty assessment for the 2005 tax year so he paid 15% of the \$1,000 consistent with the other claims for refund.

16. Once the IRS provided the underlying assessment computations, on January 28, 2008, Nagy supplemented his 2005 claim for refund by paying an additional \$596.63 to meet the 15% of a penalty requirement. (Ex. 2.)

17. On February 12, 2008, Nagy sent the IRS a Form 2297, Waiver of Statutory Notification of Claim Disallowance. (Ex. 3.)

18. On July 8, 2008, IRS denied Nagy's claims for refund for the 1997 to 2005 tax years. (Ex. 4.)

19. The IRS's wrongfully and incorrectly determined that, for the 1997 to the 2005 tax year, Nagy is liable for promoting abusive tax shelters under 26 U.S.C. §6700.

20. Due to the IRS's wrong, incorrect and reckless determinations that Nagy was promoting abusive tax shelters under 26 U.S.C. §6700, the assessments made against Nagy are illegal, and Nagy is entitled to a refund for the taxes paid for the 1997 to 2005 tax years.

CLAIM II
(Damages for Unauthorized Collection Actions)

21. Nagy incorporates paragraphs 1 to 20 above as if realleged verbatim herein.

22. Prior to making the assessments under 26 U.S.C. §6700, Nagy was never afforded the opportunity to present any facts or legal arguments

before any assessment was made, in contradiction to the IRS's affirmative representation in its notification letters and in contradiction to the I.R.M.'s requirements.

23. In November 2001, the IRS began an examination of Derivium's 1998 partnership tax return. One of the issues under examination was whether the stock loans were actually sales of stock. IRS Financial Products Specialists, Mary S. Socks conducted the analysis of stock loan transaction "using Key and Benefits/Burdens of Ownership" analysis.

24. During the examination, the IRS sent Derivium IDRs, Derivium provided responses to the IDRs, and in an August 13, 2002 letter authored by Nagy to Mary Socks, Derivium disclosed the details of the stock loans transaction and the hedging activities that were conveyed to Nagy. Mary Socks spent no less than 67 hours on her portion of the examination.

25. After the IRS analyzed the stock loan transaction, the IRS issued a no change letter dated June 16, 2003 for Derivium's 1998 income tax return. Additionally, Mary Socks, or anyone else at the IRS, never informed Derivium or Nagy that it was facilitating, administering or promoting an allegedly abusive transaction as a result of the examination.

26. As an example, Nagy was unable to assert the IRS's previous examination as a defense to the IRS's assessment of Section 6700 penalties because the IRS failed to adhere to its procedures and provide Nagy with a pre-assessment conference to raise any factual or legal defenses.

27. On January 22, 2008, the IRS filed a notice of federal tax lien against Nagy based upon the Section 6700 penalty assessments. On February 22, 2008, Nagy requested a collection due process ("CDP") hearing under 26 U.S.C. §6320 by submitting a Form 12153, which was sent by certified mail, return receipt requested and was received by the IRS on February 28, 2008.

28. The IRS's I.R.M. requires that a taxpayer's CDP request, such as Nagy's, be forwarded to the appropriate appeals office within 30 days from receiving the CDP request. As of the end of May 2008, the IRS's internal records indicate that Nagy's CDP request had not been forwarded to an appeals office, even though 3 months elapsed.

29. For the 1997 to 2004 tax years, the IRS assessed Nagy with a \$1,000 penalty under Section 6700 for all 2,765 alleged abusive transactions that Derivium Capital, LLC ("Derivium") administered. (Ex. 5.) Even though the IRS maintains the burden of proof, the IRS fails to identify the

alleged conduct that violates Section 6700 and how Nagy's alleged conduct is connected to any of these 2,765 transactions that Derivium administered.

30. Subsequent to October 22, 2004 and the 2005 tax years, the IRS assessed Nagy in the amount of \$5,428,808. Again, the IRS fails to identify the alleged conduct that violates Section 6700 and how Nagy's alleged conduct is connected to any of these post-October 22, 2004 transactions that Derivium administered.

31. The IRS computed the post-October 22, 2004 assessments by calculating 50% of the alleged gross income that IRS alleges Nagy derived or was expected to derive from the transactions that Derivium administered. The IRS computed the assessment by calculating 10% of the fair market value of borrowers' collateral securities, and then took 50% of that. (Ex. 5.)

32. Derivium's tax returns and return information demonstrate that Nagy never directly or indirectly owned an interest in Derivium, and was not a member or manager of Derivium.

33. Nagy was an outside advisor to Derivium, and the IRS knew from Derivium's return information submitted to the IRS that Nagy never directly or indirectly owned an interest in Derivium, was not a member or manager of Derivium and was unaffiliated.

34. Nagy's compensation paid by Derivium was not contingent upon or related to Derivium's revenue or sales derived from the alleged promotion and/or administration of any alleged abusive transaction.

35. The IRS's assessment of \$5,428,808 is an intentional, reckless or negligent disregard of 26 U.S.C. §6700 because no factual basis exists for Nagy to derive or expect to derive this large amount of gross income from the transactions that Derivium administered.

36. In connection with the assessments and subsequent collection activities of the Section 6700 penalties, the IRS recklessly, intentionally or negligently disregarded the Internal Revenue Code, the regulations and the IRS's procedures.

37. Under 26 U.S.C. §7433(b), Nagy is entitled to be awarded damages in an amount to be no less than \$100,000, and the costs of bringing this action.

38. Nagy exhausted the administrative processes before bringing this action. In fact, Nagy was not afforded the protections of the administrative process with regard to the Section 6700 assessments because the pre-assessment and pre-collection procedures do not apply. When Nagy was afforded administrative processes, the IRS failed to

comply with its procedures and refused to take action forcing Nagy to seek Court intervention.

CLAIM III
(Unlawful Disclosure and Inspection of Return Information)

39. Nagy incorporates paragraphs 1 to 38 above as if realleged verbatim herein.

40. Under 26 U.S.C. §7431, Nagy can recover damages when any officer or employee of the United States knowingly or negligently inspects or discloses any return or return information in violation of 26 U.S.C. §6103.

41. Subsequent to the IRS notifying Nagy that he was being investigated but before the IRS made assessments against Nagy under Section 6700 on December 28, 2007, the IRS sent a letter dated September 12, 2006 to a client of Nagy's disclosing that Nagy was under investigation by the IRS.

42. An IRS supervisor admitted that an unauthorized disclosure occurred. (Ex. 6.)

43. IRS Revenue Agents Marie Allen and Lori Dixon were the only two revenue agents who were assigned to investigate Nagy with regard to the alleged tax avoidance transactions related to Derivium and to investigate Nagy's personal income tax returns.

44. Nagy was retained by taxpayers to represent them in connection with IRS's examinations of the taxpayers' returns. IRS agents not assigned to investigate Nagy, but conducting examinations of taxpayers' returns, were advised that Nagy was personally the subject of an investigation regarding an alleged tax avoidance transaction, that Nagy's personal returns were being examined, and that Nagy prepared the tax returns for Derivium, individuals related to Derivium and other entities allegedly related to Derivium.

45. IRS Revenue Agents Paul Doerr, Richard Embusch, Sandra Fanelli, Dora Diaz and Theresa Alvarez all sent Nagy letters indicating that Nagy's return information was disclosed to them and/or inspected by them in connection with these revenue agents' investigations of third-party taxpayers. Nagy's return information being disclosed to and/or inspected by these revenue agents was an unauthorized and unlawful disclosure in violation of 26 U.S.C. §6103.

46. Upon information and belief, the IRS made additional unauthorized disclosures and permitted the unauthorized and unlawful inspection of Nagy's return information to other persons in violation of 26 U.S.C. §6103.

47. Under 26 U.S.C. §7431, Nagy seeks statutory, actual and/or special damages in an amount to be no less than \$1,000 per disclosure, plus any punitive damages. In addition, Nagy seeks his costs and attorney's fees for bringing this claim under 26 U.S.C. §7431.

WHEREFORE plaintiff, Robert J. Nagy, hereby prays that the Court:

- A. Determine that Robert J. Nagy did not engage in conduct that violates 26 U.S.C. §6700, and the Section 6700 penalties assessed against Nagy are illegal and erroneous;
- B. Order the United States to refund any payments made by Nagy against the Section 6700 penalties assessed against him for the tax years 1997 to 2005;
- C. Order the United States to pay Nagy an amount no less than \$100,000 for engaging in unauthorized collection activities under 26 U.S.C. §7433;
- D. Order the United States to pay Nagy an amount no less than \$1,000 for each unauthorized inspection or disclosure of Nagy's return information under 26 U.S.C. §7431, plus any punitive damages;
- E. Grant to Nagy his attorney's fees and costs of prosecuting this action under 26 U.S.C. §§7430, 7431 & 7433; and

F. Grant such other and further relief as may be deemed just and proper under the circumstances.

Respectfully submitted,

/s/ Lindsey W. Cooper Jr.
LINDSEY W. COOPER JR. (No. 9909)
The Law Offices of L.W. Cooper Jr., LLC
36 Broad Street
Charleston, SC 29401
Telephone: 843.723.5152
Facsimile: 843.577.4570

Counsel for Robert J. Nagy

Dated: July 15, 2008
Charleston, South Carolina

JURY TRIAL DEMANDED